Philippines—Update

Yield Movements

Yields of Philippine government bonds fell for most maturities between end-December 2009 and mid-August 2010 **(Figure 1)**. Yields dropped for most maturities at the shorter-end of the curve. But the decline was relatively larger from the belly through the longer-end of the curve, falling by 65, 135, 121, 103, and 53 basis points for 5-, 7-, 10-, 20-, and 25-year maturities, respectively. Meanwhile, yield spreads between 2- and 10-year tenors narrowed by 121 basis points between end-December and mid-August.

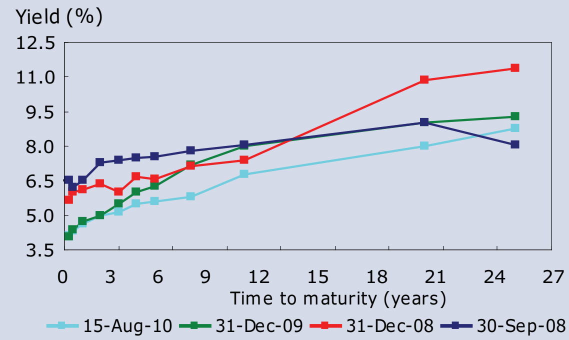
In August, the central bank—Bangko Sentral ng Pilipinas—held the overnight borrowing (reverse repurchase) and overnight lending (repurchase) rates steady at 4.0% and 6.0%, respectively. Consumer price inflation in the Philippines stood at 4.0% year-on-year (y-o-y) in August, compared with 3.9% in July. The Philippines registered gross domestic product (GDP) growth of 7.9% y-o-y in 2Q10, following revised 7.8% growth in 1Q10, on the back of double-digit growth in domestic investment, total exports, and industrial activity.

Size and Composition

The size of the Philippine local currency (LCY) bond market expanded 11.6% y-o-y, and 2.5% quarter-on-quarter (q-o-q), to PHP3.1 trillion (USD66.2 billion) as of end-June **(Table 1)**. This growth stemmed from increases in both government bonds and corporate bonds outstanding.

The size of the Philippine LCY government bond market amounted to PHP2.7 trillion (USD58.1 billion) at the end of June, a 9.8% y-o-y increase. Treasury bonds, which comprised 74% of total government bonds, expanded 18.3% y-o-y to PHP2.0 trillion (USD43 billion). In contrast, treasury bills plunged 16.5% y-o-y to PHP567.4 billion (USD12.2 billion). Other bonds, which include government-guaranteed bonds and bonds owned by government-owned-and-controlled corporations (GOCCs) totaled PHP131.7 billion (USD2.8 billion), which represented increases of 47.9% y-o-y and 18.1% q-o-q.

Figure 1: Philippines' Benchmark Yield Curve–LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

In 2Q10, the Philippine government issued a total of PHP127.8 billion (USD2.7 billion) in government bonds, of which 63.2% were treasury bills and 13.3% were treasury bonds. The remaining 23.5% were issued by a Philippine GOCC, the Power Sector Assets and Liabilities Management Corp. (PSALM).

In September, the Philippines issued PHP44.1 billion (USD1.0 billion) of 10-year bonds in international capital markets; this served as the first LCY bonds sold offshore by an Asian country. The bonds have a coupon rate of 4.95%, a yield of 5.0%, and were priced at 99.607%. About 37% of the bond purchases came from Asian investors, 33% from US investors, and 30% from European investors. The bonds are exempt from the Philippines' 20% tax on interest income.

Philippine LCY corporate bonds outstanding soared 26.8% y-o-y to PHP376.2 billion (USD8.1 billion) in June. On a q-o-q basis, corporate bonds outstanding climbed 5.5%. During 2Q10, four LCY corporates issued a total of PHP18.0 billion (USD388.1 million) in bonds: Ayala Corporation (PHP10.0 billion), Rizal Commercial Banking Corporation (PHP5.0 billion), Metrobank Card Corporation (PHP2.0 billion), and SM Prime Holdings (PHP1.0 billion).

Table 1: Size and Composition of the LCY Bond Market in the Philippines

	Amount (billion)								Growth Rate (%)						
	Mar-10		Apr-10		May-10		Jun-10		Mar-10		Apr-10	May-10	Jun-10		
	PHP	USD	PHP	USD	PHP	USD	PHP	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	2,996	66	3,029	68	3,060	66	3,072	66.2	11.1	2.9	1.1	1.0	11.6	2.5	0.4
Government	2,639	58	2,670	60	2,684	58	2,696	58	7.3	3.1	1.2	0.5	9.8	2.1	0.4
Treasury Bills	579	13	579	13	575	12	567	12	(24.6)	(6.9)	0.0	(0.7)	(16.5)	(2.0)	(1.3)
Treasury Bonds	1,948	43	1,938	44	1,977	43	1,996	43	21.0	6.0	(0.6)	2.0	18.3	2.5	1.0
Others	112	2	153	3	132	3	132	3	35.2	12.0	37.0	(13.8)	47.9	18.1	0.0
Corporate	357	8	359	8	376	8	376	8	51.0	1.5	0.8	4.7	26.8	5.5	0.0

LCY = local currency, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Note:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY—USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. "Others" includes government-guaranteed bonds such as Land Bank of the Philippines and National Power Corporation (Napocor).
Source: Philippine Bureau of the Treasury and Bloomberg LP.

The top 20 LCY corporate issuers in the Philippines, as of June 2010, had combined LCY bonds outstanding of PHP301.1 billion, which represented 80% of the overall LCY corporate bond market **(Table 2)**. San Miguel Brewery, the largest beer producer in the country, had LCY bonds outstanding of PHP38.8 billion, followed by three commercial banks—Banco de Oro Unibank (PHP30.9 billion), Rizal Commercial Banking Corporation (PHP21.0 billion), and Metrobank (PHP18.5 billion).

Rating Changes

In August, Fitch Ratings affirmed the sovereign credit ratings of the Philippines at BB for its foreign currency (FCY) long-term issuer default

Table 2: Top 20 Issuers of LCY Corporate Bonds in the Philippines, June 2010

Rank	Issuer	Amount Outstanding (PHP billion)
1	San Miguel Brewery	38.80
2	Banco de Oro Unibank	30.90
3	Rizal Commercial Banking Corporation	21.00
4	Metropolitan Bank & Trust Company	18.50
5	Manila Electric Company	18.30
6	Philippine National Bank	17.75
7	Globe Telecom	16.80
8	Petron Corporation	16.30
9	Ayala Corporation	16.00
10	Robinsons Land Corporation	15.00
11	JG Summit Holdings	13.31
12	SM Prime Holdings	12.49
13	Energy Development Corporation	12.00
14	Bank of Philippine Islands	10.00
15	SM Investments Corporation	9.40
16	Allied Banking Corporation	8.00
17	Ayala Land	7.00
18	Aboitiz Power Corporation	6.88
19	Megaworld Corporation	6.40
20	Metrobank Card Corporation	6.30
Total Top 20		**301.13**
Total LCY Corporate Bonds		**376.17**
Top 20 as % of Total LCY Corporate Bonds		**80%**

LCY = local currency.
Source: Bloomberg LP.

rating, BB+ for its LCY long-term issuer default rating and country ceiling, and B for its short-term issuer default rating **(Table 3)**. Fitch Ratings also affirmed its stable outlook for the Philippines.

Table 3: Selected Sovereign Ratings and Outlook for the Philippines

	Moody's	Standard & Poor's	Fitch
FCY Long-Term Rating	Ba3	BB–	BB
Outlook	stable	stable	stable

FCY = foreign currency.
Source: Rating agencies.

Policy, Institutional, and Regulatory Developments

Bond Exchange Program Planned

In August, the Philippine Bureau of the Treasury revealed its plan to allow the exchange of shorter- and longer-term bonds in order to lengthen the maturity profile of the Philippine government's debt. In particular, 5-year government bonds can be exchanged for 10-year bonds, while 10-year bonds can be exchanged for 20- or 25-year bonds. This bond exchange program is expected to be launched by the end of the year.

PDEx Revises Rules on Failed Trades and Delayed Settlements of Fixed-Income Securities

In May, the Philippine Dealing and Exchange Corporation (PDEx) amended its rules for the Philippine fixed-income securities market. PDEx revised certain provisions on the definition, reporting, handling, and penalties of failed trades and delayed settlements of fixed-income securities.